BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 92-619-E - ORDER NO. 93-465

JUNE 7, 1993

IN RE: Application of South Carolina Electric & Gas Company for an Increase in the Company's Electric Rates and Charges.	) ORDER APPROVING) RATES AND CHARGES)

I.

INTRODUCTION

This matter is before the Public Service Commission of South Carolina (the Commission) on the December 7, 1992 Application of South Carolina Electric & Gas Company (SCE&G or the Company) for adjustments in the Company's electric rates and charges, and for changes in the Company's terms and conditions of service. The Application was filed pursuant to S.C. Code Ann.,§58-27-870 (1976, as amended), and 26 S.C. Regs. 103-821 of the Commission's Rules of Practice and Procedure.

By letter, the Commission's Executive Director instructed the Company to cause to be published a prepared Notice of Filing and Hearing, one time, in a newspaper of general circulation in the area affected by the Company's Application. The Notice of Filing and Hearing indicated the nature of the Company's Application and advised all interested parties desiring participation in the scheduled proceeding of the manner and time in which to file the appropriate pleadings. The Company was likewise required to directly notify all customers affected by the proposed rates and charges. The Company furnished affidavits demonstrating that the Notice had been duly published in accordance with the instructions of the Executive Director and certified that a copy of the Notice had been mailed to each customer affected by the rates and charges proposed in the Company's Application. Petitions to Intervene were received from the Consumer Advocate for the State of South Carolina (the Consumer Advocate), the City of Orangeburg (Orangeburg), the United States Department of Navy (Navy), the South Carolina Energy Users Committee (SCEUC), and from Hugh Bahar.

The Company's presently authorized rates and charges were approved by Order No. 89-588, issued July 3, 1989, in Docket No. 88-681-E. The rates and charges as originally requested by the Company would produce an increase in annual revenues of approximately $93.1 million dollars, and provide a return on common equity of 13.05%, according to the Company's calculations. By letter of March 25, 1993, the Company informed the Commission that due to change in market conditions, it was revising its request, and would now seek a return on common equity of 12.05%. This change would produce an increase in annual revenues of $76.4 million. On March 29, 1993, the Company and the Commission Staff entered into a stipulation in which the parties agreed to certain adjustments resulting in a further decrease in annual revenues of approximately $4.2 million. As a result of these changes, the Company sought, at the onset of the hearing, an increase in annual revenues of $72.2

million, for a return on common equity of 12.05%, and a return on rate base of 10.9%.

The Commission Staff made on site investigations of the Company's facilities, audited the Company's books and records, and gathered other detailed information concerning the Company's operations. The Consumer Advocate and SCEUC likewise conducted discovery in the rate filing of SCE&G.

A public hearing was held in the Offices of the Commission from March 29, 1993 through April 1, 1993 and April 26, 1993. During that period, night hearings were held in the cities of Columbia, Charleston and Aiken.

The evidentiary hearing began in the Commission's offices on March 29, 1993 before the Commission, with the Honorable Henry G. Yonce presiding. SCE&G was represented by Belton T. Zeigler, Esquire, and Francis P. Mood, Esquire. The Consumer Advocate for the State of South Carolina was represented by Steven W. Hamm, Esquire, Nancy V. Coombs, Esquire, Carl F. McIntosh, Esquire, and Hana Williamson, Esquire. The Intervenor, City of Orangeburg, was represented by James M. Brailsford, III, Esquire. The Intervenor, United States Department of Navy, was represented by Maureen C. Lindsey, Esquire. The South Carolina Energy Users Committee was represented by Arthur G. Fusco, Esquire. Hugh Bahar appeared *pro se* only at the Aiken night hearing. The Commission Staff was represented by F. David Butler, General Counsel, and Florence P. Belser, Staff Counsel.

The Company presented the testimony of Lawrence M. Gressette, Jr., Bruce D. Kenyon, William B. Timmerman, Jimmy E. Addison, John D. Gregg, III, George C. How, John D. McClellan, Eugene F. Brigham, George A. Schrieber, Jr., and on reply, presented the testimony of Edward L. Delahanty. The Consumer Advocate presented the testimony of Philip E. Miller and John B. Legler. The parties stipulated into evidence the testimony of Maurice Brubaker on behalf of the Intervenor, United States Department of Navy, and the testimony of Nicholas Phillips, Jr. on behalf of the South Carolina Energy Users Committee. The Commission Staff presented the testimony of Curtis Price, A.R. Watts, Gary E. Walsh, and James Spearman.

II.

FINDINGS OF FACT

Based upon the Application, the testimony, and exhibits received into evidence at the hearing and the entire record of these proceedings, the Commission now makes the following findings of fact:

1. South Carolina Electric & Gas Company is an electrical utility operating in 24 counties in the central and southern areas of South Carolina where it is engaged in the generation, transmission, distribution and sale of electricity to the public for compensation. SCE&G's retail electric operations in South Carolina are subject to the jurisdiction of the Commission pursuant to S.C. Code Ann.,§58-27-10, et seq. (1976), as amended. SCE&G's wholesale electric operations are subject to the jurisdiction of the Federal Energy Regulatory Commission (FERC). In addition to its electric operations, SCE&G also provides natural gas services,

subject to the jurisdiction of the Commission pursuant to S.C. Code Ann.,§§58-5-10, et seq., (1976), as amended, in the central and southern areas of South Carolina. SCE&G also provides motor coach services in the Columbia and Charleston areas, subject to the Commission's jurisdiction pursuant to S.C. Code Ann., §§58-23-10, et seq. (1976), as amended.

2. The appropriate test year period for the purposes of this proceeding is a twelve-month period ending September 30, 1992.

3. The Company sought at the onset of the hearing, an increase in annual revenues of $72.2 million.

4. The appropriate operating revenues for the Company's retail operations for the test year under present rates and after accounting and pro forma adjustments are $819,680,000.

5. The appropriate operating revenues for SCE&G's retail operations under the approved rates are $879,590,000, which reflects a net authorized increase in operating revenues of $60,504,000, including authorized recovery of $594,106 in demand side management (DSM) incentive.

6. The appropriate operating expenses for the Company's South Carolina operations for the test year under its present rates and after accounting and pro forma adjustments are $654,641,000.

7. The appropriate operating expenses for the Company's retail operations under the approved rates are $677,138,000.

8. The Company's reasonable and appropriate federal and state income tax expense should be based on the use of a 34%

federal tax rate and a 5.0% state tax rate, respectively.

9. The Company's appropriate level of net operating income for return and after accounting and pro forma adjustments is $166,838,000 for SCE&G's retail operations.

10. The appropriate net income for return under the rates approved and after all accounting and pro forma adjustments is $204,659,000 for retail operations.

11. A year-end original cost rate base of $2,088,354,000 for retail operations consisting of the components set forth in Table B of this Order shall be adopted.

12. The capital structure utilized by the Commission in this proceeding for the determination of the fair overall rate of return is the capital structure of South Carolina Electric & Gas, updated to December 31, 1992.

13. The embedded cost rate for long-term debt of 8.29% and its embedded cost rate for preferred stock of 7.70% as of December 31, 1992 have been used in the determination of the fair overall rate of return approved herein.

14. The fair rate of return on common equity which SCE&G should be allowed the reasonable opportunity to earn is 11.50%-12.00%, with rates to be set at 11.50%, which is adopted by the Commission for this proceeding. The capital structure and cost of capital which the Commission has approved herein produce an overall rate of return of 9.80% for SCE&G retail electric operations as depicted in the following table:

TABLE A

COMPONENT OF CAPITAL STRUCTURE	RATIO %	EMBEDDED COST/RATE %	OVERALL COST/RATE %
Long Term Debt	47.95	8.29	3.98
Preferred Stock	4.20	7.70	.32
Common Equity	47.85	11.50	5.50
TOTAL	100.00	-	9.80

15. A cost recovery mechanism for Demand Side Management (DSM) programs is appropriate so that SCE&G may recover its costs for qualified DSM programs. As per South Carolina law, an additional incentive is appropriate for the Company, in order to encourage the development and application of DSM programs.

16. The rate designs and rate schedules approved by the Commission and the modifications thereto as described herein are appropriate and should be adopted.

III.

STIPULATIONS

In prefiled testimony, the Staff of the Public Service Commission of South Carolina, the Consumer Advocate, and the South Carolina Energy Users Committee identified issues that they sought to raise related to the Application by SCE&G. To encourage the discussion and possible settlement of these issues, a prehearing conference was held in the Offices of the Public Service Commission on March 19, 1993. As a result of the discussions held at that conference, a Stipulation was entered into between the South Carolina Public Service Commission Staff and South Carolina Electric & Gas Company dated March 29, 1993. That Stipulation concerns certain accounting issues, certain issues related to the proof of demand-side management issues and certain issues related to the Company's tariffs, and terms and conditions of service. It was entered into the record of this proceeding as Hearing Exhibit 1.

The Public Service Commission Staff, the Company, the Department of Navy and the South Carolina Energy Users Committee also entered into a Stipulation dated March 26, 1993. That Stipulation concerned issues related to cost of service, distribution of rate increases to classes of customers and rate design. That Stipulation was entered into the record of this proceeding as Hearing Exhibit No. 2.

On April 22, 1993, the Company and Commission Staff entered into a second Stipulation concerning DSM cost recovery and related issues. The supplemental Stipulation was entered into the record as Hearing Exhibit No. 38.

In these Stipulations, the Company agreed to many of the points advanced by the Commission Staff, the Energy Users Committee and the Department of the Navy. Although the Consumer Advocate was not a party to any of the Stipulations, in many cases the Stipulation brought the Company's position in line with the position advanced by the Consumer Advocate. Accordingly, the Stipulations have served to greatly reduce the matters at issue before the Commission and greatly simplify the course of the proceedings. The Stipulations are discussed further below.

IV.

EVIDENCE AND CONCLUSIONS

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 1

The evidence supporting this finding concerning the Company's business and legal status is contained in the Company's Application and in prior Commission orders and the docket files in which the Commission takes notice. This finding of fact is essentially informational, procedural, and jurisdictional in nature and the matters it involves are essentially uncontested.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 2

The evidence for this finding concerning the test period is contained in the Application of the Company and the testimony and exhibits of Company witness Addison, and Staff witness Price. A fundamental principle of the ratemaking process is the establishing of a test year period. The reliance upon the test year concept, however, is not designed to preclude the recognition and use of other historical data which may preceed or post date the selected twelve month period.

Integral to the use of a test year, representing normal operating conditions to be anticipated in the future, is a necessity to make normalizing adjustments to the historic test year figures. Only those adjustments which have reasonable and definite characteristics and which tend to influence reflected operating expenses are made to give proper consideration to revenues, expenses, and investments. Parker v. South Carolina Public Service Commission, et.al., 280 S.C. 310, 313 S.E.2d 290 (1984).

Adjustments may be allowed for items occurring in the historic test year but which will not recur in the future; or to give effect to items of a extraordinary nature by either normalizing or annualizing such items to reflect more accurately their annual impact; or to give effect to any other item which should have been included or excluded during the historic test year. The Commission finds that the twelve months ending September 30, 1992 to be the reasonable period for which to make its ratemaking determinations therein.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 3-10

Certain adjustments affecting expenses were included in the exhibits and testimony offered by Company witnesses Addison, McClellan and Gregg, witness Miller for the Consumer Advocate and witnesses Price, Watts and Walsh for the Commission Staff. This Order will address in detail only those accounting and pro forma adjustments affecting expenses which differed between the Company, the Consumer Advocate and the Commission Staff.

A. Employee and Officer Incentive Programs

South Carolina Electric & Gas Company operates employee incentive programs applicable to non-officers and officers. Under the non-officers program, the Company sets corporate goals at the beginning of each year and awards incentives to employees depending upon the degree to which those goals are achieved. Incentive plans for employees have been in effect since 1986 and the Company has demonstrated a consistent payout history under them.

The incentive plans are self-funding. The amount of the incentive pay is in all cases less than the amount of O&M savings generated because of the incentives. The efficacy of these programs is documented in the reply testimony of Company witness Gressette. Since 1986, the Company has set an incentive goal of reducing O&M expenditures below budgeted levels. During this period, the gross amount of savings at electric operations, O&M budgets has been $61.8 million against total incentive payouts of $14.8 million for a net savings to the customers of $47 million (TR. 1, at 78). A similar pattern exists for the test period in the years 1991 and 1992. The Company reduced O&M expenses for electric operations by a total of $23.2 million against incentive payouts of $5.8 million. The plan has also targeted reductions in sick leave rates and lost time accidents. The resulting savings for electric operations during the test year were approximately $1.3 million compared to sick leave and accident rates before implementation of the incentive program. Another goal of the employee incentive program has been to reduce the Company's capital spending below the annual budget amount. As Mr. Gressette testified, the Company was able to reduce its capital spending below budget during the years 1991 and 1992 by an amount in excess of $31.8 million. That resulted in the decrease in the present rate request of approximately $7 million.

The Company also provides incentives to SCE&G's officers. These incentives are based either on long or short term performance of the Company. The Company uses measures from the employee incentive plan plus earnings and stock performance data to determine the amount of the incentives. Officer incentives are a part of the executive compensation package for the Company.

The Commission Staff and Consumer Advocate have eliminated from cost of service the impact of the incentive benefit package for non-officers and officers during the test year. The Staff's adjustment includes a disallowance of expense for both non-officers and officers included in test year operation and maintenance expenses. The Consumer Advocate's adjustment cited in his brief of $3,523,000 reflects only the amounts actually paid under the incentive plan during the test year. The Commission has examined this matter, and believes that the non-officers incentive programs constitute a valid utility operating expense, and the expense is therefore included in test year expenses. The Company has demonstrated direct benefits to customers in excess of the cost of the program. These cost savings are passed to customers directly through rate proceedings such as this. Accordingly, the Commission approves the inclusion of amounts attributable to the non-officer employee incentives during the test year in rates in the amount of $3,900,000.

However, the Commission hereby rejects the expense claimed for officers' incentives. The Commission agrees with the Company's position, as set forth in the testimony of Messrs. Gressette and Delahanty, that direct benefits to customers in the form of cost savings may be created by achievement of the officer incentive goals. The Commission agrees that, in the proper circumstances, earnings levels and levels of investor returns can be valid measures of a utility's ability to operate efficiently within the revenues authorized by this Commission and of its success in offsetting cost increases with increases in efficiencies. As such, these standards can be valid standards, among others, for the payment of incentives to officers.

The Commission further agrees that executive compensation packages, including both base salaries and incentives, may be properly viewed as a whole. The Commission finds, based on the testimony of Mr. Delahanty, that the utility industry is moving, as non-regulated industries have already done, towards increased "at risk" or incentive compensation. The Commission sees the move towards greater "at risk" compensation as one that has significant potential benefits for utility customers in the form of more efficient, motivated and goal-oriented utility management.

The Commission, however, does not believe that this is the proper proceeding in which to allow these "at risk" elements of officer compensation into rates. The Company's pay structure for officers continues to evolve as does experience with incentive pay for officers in the utility industry generally. The Commission will seriously consider requests by the Company for the rate recovery of "at risk" or incentive compensation for officers in future proceedings without prejudice in any way from the denial of such recovery here. However, the Commission disallows the amount of $1,913,000 for the officers incentive program in this case consistent with the Commission's decision regarding officers' salaries.

B. Pension Expense.

The Staff and Company have utilized test year pension expense in prefiled exhibits. Consumer Advocate witness Miller, in prefiled exhibits, proposed an annual pension cost amount of $1,397,000. During testimony, witness Miller indicated that an acceptable option would be to utilize calendar year 1992 pension expenses versus test year expense. This option would reduce test year pension expense by $1,047,000 on a South Carolina retail basis. The Consumer Advocate argued in its brief that the test year pension expense should be based upon the latest actuarial study. This study which is a source for the 1992 pension expense would reduce the total Company test year expense of $4,818,000 by $1,094,000. According to the Consumer Advocate, this annualization is appropriate and is also consistent with the treatment of pension expense by other regulatory commissions. The Consumer Advocate maintains that if the Commission accepts the Company's proposal to annualize its test year salaries and wages, the consistent ratemaking treatment also requires the annualization of the test year pension expense. Since the record is clear that the test year pension expense is higher than the cost recommended in the Company's latest actuarial study, it is appropriate to recognize this cost reduction in this proceeding since it is a known and measurable change. The Commission, therefore, adopts the Consumer Advocate's ultimate position to reduce test year pension expense by $1,047,000 on a South Carolina retail basis.

C. Advertising Expenses Related to Chernoff-Silver.

The Staff proposed that test year operating and maintenance expenses be reduced by $438,000 to reflect the removal of charges associated with the Chernoff-Silver advertising firm, which in the past, had done work for the Company in the lobbying and public relations area. As set forth in the Staff and Company stipulation on page three, the Staff has reviewed the invoices and ad copy concerning the Chernoff-Silver charges, and has determined that the expenses constitute energy conservation advertising expenses. Company witness Addison testified to the same effect (TR. Vol. 4, at 60). The Commission has consistently ruled that energy conservation advertising expenses are reasonable and necessary utility expenses, and are properly included in rates. They provide direct benefits to customers by reducing their energy bills and reducing capital expenditures by the utility to meet increased demand. The Commission finds that the Chernoff-Silver expenses are properly included in utility expenses in this rate proceeding.

D. EEI Dues.

The Staff and Company have included the cost during the test year for dues to EEI, excluding grass roots lobbying expense. Consumer Advocate witness Miller in prefiled exhibits has excluded all expenses associated with EEI dues. During cross-examination of witness Miller, he asserted that an acceptable option would be to exclude 25% of EEI dues included in test year expense for non-allowable expenses. This would result in a reduction of test year expense associated with EEI dues on a South Carolina retail basis of $82,000. The Consumer Advocate in his brief revised his percentage to be disallowed for non-allowable to 29.34%. The Commission, for the following reasons, adopts the Consumer Advocate's revised position, which would exclude 29.34% of EEI dues as non-allowable expenses.

Consumer Advocate witness Miller testified that on the basis of his review of the latest report issued by the NARUC Oversight Committee, it was his opinion that not all the EEI expenses provide a direct and primary benefit to consumers. This report entitled Report of EEI Financial Operations in Accordance with Established Definitions, Methodologies and Guidelines of the NARUC Oversight Committee is based upon the latest EEI audit. The report was issued in March 1992 and is for calendar year 1990 data.[1] Based upon his review of this report, Mr. Miller indicated that there were several EEI activities which did not provide a direct and primary benefit to consumers. These include EEI's charitable contributions, memberships in social and service club organizations, lobbying activities, and advertising expenses. In this regard, this analysis showed that 14% of EEI's 1990 operating expenses were incurred for legislative advocacy functions. The cost incurred for this category of expenses consist of efforts to influence the course of federal or state legislative actions,

1. The Company lodged objections to the attempted introduction of this report as evidence based on hearsay grounds. The Commission hereby overrules the Company's objections based on the public records exception to the hearsay rule. The report shall be admitted as Hearing Exhibit No. 16.

including the cost reported under the Federal Regulation of Lobbying Act.

Although the Company did not initially provide any support for the inclusion of EEI costs in its test year operating expenses, it did provide some support in its rebuttal testimony. Essentially, it is the Company's position that the benefits exceed the cost and that, therefore, the total cost should be allowed.

It is the Commission's position that the only reasonable method to determine whether or not all or a portion of the EEI expenditures should be allowed is to analyze the aforementioned NARUC oversight report and to base the elimination on a portion of the EEI expenditures which do not provide a direct and primary benefit to the ratepayers. This would be consistent with our Supreme Court's ruling in Hamm v. South Carolina Public Service Commission, 422 S.E.2d 110 (1992). The Court cited, with approval, decisions of Hawaii and Kentucky commissions regarding the need to demonstrate a direct benefit of these dues to the ratepayers in disallowing a portion of EEI dues used for lobbying efforts, charitable contributions, and social functions. Consistent with this philosophy, the Commission finds that the following percentage be excluded from EEI expenses for ratemaking purposes:

Legislative Advocacy	14.05%
Legislative Policy Research	6.29%
Regulatory Advocacy	2.84%
Regulatory Policy Research	4.38%
Advertising	0.54%
Contributions and Club Dues	1.24%
TOTAL:	29.34%

This would eliminate $96,000 as non-allowable expenses annually.

E. Demolition of Parr and Hagood Plants.

The Commission Staff and SCE&G propose to accrue and amortize for recovery over the next five years the demolition costs net of salvage of the Hagood and Parr plants. The Company is retiring these plants in 1993. As a general matter, depreciation rates for generating plants are set to recover the original cost of such plants, plus demolition costs, less salvage value. These depreciation rates are adjusted from time to time as conditions change.

In the case of Parr and Hagood, however, the recent increase in environmental regulation has greatly increased the cost of demolition. As a result, at the time of retirement of these plants, $1.9 million in demolition costs, net of salvage value, will not be recovered through depreciation rates. These salvage costs are related primarily to asbestos removal and other environmental requirements.

The Consumer Advocate's witness, Mr. Miller, asks that these amounts be amortized over a ten-year period, rather than the five-year period proposed by the Company. This will lessen the impact of the costs on present ratepayers. The Commission agrees that this ten-year amortization period is a reasonable means of balancing the interests of the Company in a timely recovery of its demolition costs with the interest of ratepayers in minimizing the rate impact of the recovery of those costs. Accordingly, the

Commission approves an amortization period of ten years.

Mr. Miller does not object to the inclusion of these demolition costs and rates, but does take the position that it is premature to begin this amortization at the present. He bases his position on the fact that all demolition contracts have not been let and demolition will take as long as eighteen months to complete. The Commission disagrees with Mr. Miller on this question of timing. Contracts for demolition work on both facilities have been put out for bids and bids have been received. As the Company witnesses have testified, the bid amounts support the $1.9 million demolition charge which the Company intends to place in the accrual account. Further, as the Company witness Addison testified at the time of hearing, bids had been received on the Hagood plant at a bid conference and the Company was prepared to let contracts any day. (TR. Vol. 4, Addison, at 75) The award of a bid at the Parr plant had been delayed due to a pre-bid change order relating to additional cost for abatement of recently discovered lead paint at that facility (TR. Vol. 4, at 76). However, the change order could only increase, not decrease, the cost of demolition. In short, the $1.9 million figure proposed to be accrued and amortized at this time is, if anything, less than the total cost of demolition, and is supported by valid bids in hand. Accordingly, the expenses in question are known and measurable at this point, and are properly included in rates. Inasmuch as they can be amortized over a ten year period, the Commission can in subsequent proceedings, adjust the total amount to be recovered to match the total amount spent, should there be any difference between the $1.9 million accrued now and the final cost at demolition. In any event, delay in recovery to a future rate case is not appropriate. It improperly delays recovery of the expenses and further distances a recovery from the customers who have used the Parr and Hagood plant and have received the benefit from them. Further, in case of such delay, the continued accrual of carrying costs on the deferred amounts would increase the total amount to be recovered over time. For these reasons, the Commission rejects the Consumer Advocate's position that recovery of these amounts should be deferred until future proceedings. The Commission does, however, adopt the position of Consumer Advocate witness Miller with regard to the elimination of operating and maintenance expenses associated with Parr and Hagood during the test year. The Commission therefore reduces amortization costs, originally set at $502,000 to $251,000. Accumulated amortization is reduced by $251,000, thus giving the Company carrying costs on the unamortized balance. Also, the jurisdictional test year operation and maintenance expenses should be reduced by $66,185. See, Hearing Exhibit No. 28.

F. Officers' Salary Increases.

The Staff and Consumer Advocate have eliminated from cost of service the impact of Officers' Salary Increases during the test year. This treatment is consistent with recent Commission decisions, and, because of the continuing evolution of complete executive compensation packages as described in Part A with regard to officers' incentive programs, the Staff and Consumer Advocate adjustment should be granted. Therefore, the Commission adopts a reduction of $109,000 annually from cost of service.

G. Health Care Costs.

The Staff and the Company have annualized the test year expense to reflect the percentage increase from September 30, 1991 to September 30, 1992 and would, therefore, recommend an adjustment of $759,000 annually for retail electric health care costs. The Consumer Advocate's adjustment represents the affect of annualizing of the last quarter of 1992 and adjusting the per book expense to that annualized level. The Consumer Advocate recommends the removal of $872,000 annually from expenses. The Consumer Advocate's adjustment would reduce the health care costs significantly below the test year amounts.

Company witness Addison stated that health care plans and related deductibles and co-payments are administered on a calendar year basis (TR. Vol. 4, at 26, 27, and 49-52). Employee practices for filing claims vary greatly, in that there are significant fluctuations in the rate of filings from month to month or season to season. For this reason, health care costs must be analyzed according to the Company on a calendar year basis. The Company contends that it is inappropriate to select health care expenses for a single quarter for annualization.

The Commission agrees with this reasoning, and also agrees that the danger of annualized quarterly health care expenses is apparent in Mr. Miller's proposal. The level of health care expenses for the three months ended December 31, 1992 are, in fact, unusually low when measured both against test year expenses and expenses for the early months of 1993. Accordingly, the evidence shows that reliance on annualized fourth quarter 1992 data that Mr. Miller suggests would result in a significant understatement of the health care expenses typically experienced by the Company.

Miller further challenges the Company's adjustment to its health care expenses to reflect the Company's historical annual increases in health care costs. For purposes of that adjustment, the Company compared the health care costs for the test year to similar costs in the prior twelve month period to determine a percentage increase. That increase was then applied to the test year numbers to determine the level of health care costs that the Company would expect to incur during the time the rates to be approved here would be in effect. The resulting adjustment was approximately 9.97% or $793,000 on a system basis.

As stated in Mr. Addison's testimony, the United States Department of Commerce has determined that health care costs will increase by 12% to 15% per year over the next five years. This is consistent with the Company's recent experience which has been an annual growth rate of approximately 14.4% in health care costs over the last five years. TR. Vol. 4, at 51. The Commission finds that increases in health care costs are known and are properly measurable based on the Company's past experience, as verified by the official government data. Accordingly, the Commission accepts the adjustment to health care costs as proposed by the Company and the Staff.

H. Demand-Side Management Costs.

The Staff and Company have included Demand-Side Management (DSM) expenses to reflect an annualized amount based on the last quarter of 1992. In addition, this annualized amount has been adjusted for expenses from prior test years associated with the Great Appliance Trade-Up (GATU) program for a reduction to expenses of $314,000 annually. Consumer Advocate witness Miller has recommended using test year DSM costs. Because of the reasoning stated below, the Commission adopts the Staff and the Company's position.

South Carolina Electric & Gas Company proposes to recover the Company's expenses related to certain demand-side management programs, which the Commission found to be reasonable and consistent with the Company's IRP. These DSM programs are programs designed to either reduce energy demand (kw), reduce energy usage (kwh) or to shift usage to non-peak periods, increasing efficiency, thereby reducing SCE&G's requirements to build new capacity. In each instance, the expected benefits exceed the expected costs of the options. SCE&G initially proposed that it be allowed to recover qualifying DSM expenditures at projected 1993 levels. The reason for this proposal was that the Company's level of DSM expenditures is increasing rapidly. Test year expenses were below the expenditure levels anticipated during the period that the rates will be in effect. The Company also argued that the projected DSM expense levels should be recognized to provide the Company an incentive to encourage its investment in cost-effective DSM programs.

The Commission Staff agreed generally with the logic of this proposal, but proposed that the Company's test year DSM expense for qualified programs be set at the annualized level of expenditures the Company experienced in the fourth quarter of 1992 instead of 1993 budgeted amounts. This adjustment brings the DSM expense recovery into line with the current spending levels, while still establishing costs on actual spending levels. In the Staff's stipulation, the Company agreed with this proposal. The Commission accepts, for this proceeding, this aspect of the stipulation, and finds that annualized fourth quarter 1992 DSM expenditure levels are the proper basis for measuring the level of DSM expenditures to be included in the proposed rates.

The Company also proposes that it be allowed to accrue DSM expenditures for all programs to the extent that DSM expenditures exceed the expenditures permitted in rates in this proceeding. The Company proposes to defer these amounts with carrying costs equal to the Company's overall cost of capital as established in this proceeding. These additional DSM expenses, plus carrying costs would be amortized in the rates in future proceedings to the extent that the DSM programs after review qualify for cost recovery. The Commission agrees with the Company's proposed treatment of these DSM expenditures. Absent some mechanism for accruing amounts not recovered through rates for future recovery, the Company would, in effect, be discouraged from making cost-effective DSM expenditures above the levels incorporated in rates. Fairness and the public interest in encouraging investment in cost-effective DSM programs amply justify the deferral and amortization requested. The DSM incentive granted herein of $594,106 is discussed on pp. 59-63, infra.

I. Employee Moving Expenses.

Both the Staff and the Consumer Advocate objected to the inclusion of employee moving and relocation expenses at the test year level due to the fact that expenses during the test year exceeded typical levels. As explained by the Company, this resulted from an unusual number of employee relocations during that period due to the Company's restructuring efforts to meet changes in the industry. In the Staff's stipulation at page four, the Company agrees to the proposal set forth by the Staff and reiterated by the Consumer Advocate's witness Miller that the employee moving expenses be based on a five year average. This reduces O&M expenses by $508,000. The Commission accepts this adjustment.

J. Depreciation Adjustment to Reflect New Accruals.

The Staff and Company have calculated per book depreciation for the test year using the proposed depreciation study including construction work in progress closed to plant at 2-24-93. The Staff and Company recommend removal of $197,000 annually from O&M expenses. The Consumer Advocate witness Miller has utilized a plant-in-service amount which included CWIP closed to plant, based on a budgeted amount. Since the Commission believes that the Staff and Company's figure is more reflective of actual expenses, the Commission adopts the Staff and Company's adjustment.

K. Adjustment to Annualized Depreciation Expense.

The Staff and Company have annualized depreciation expense to reflect test year plant-in-service including CWIP closed to plant at 2-24-93. In his brief, the Consumer Advocate agreed with the Staff and Company position to allow $4,501,000 as an annual adjustment to annualized depreciation expense. The Commission adopts this adjustment.

L. Hurricane Andrew Charges.

The Staff and Company have increased payroll expense to reflect the normalized payroll cost, had individuals not been compensated by Florida Power & Light for assistance following Hurricane Andrew. Consumer Advocate witness Miller has rejected this adjustment. However, the Consumer Advocate, in his brief, agreed with the inclusion of the $150,000 in expense, and recommended that the reimbursement from Florida Power & Light be amortized over a three-year period. The Commission adopts the Consumer Advocate's adjustment found in his brief.

M. Taxes Other Than Income Taxes.

The Staff and Company have increased taxes other than income taxes to normalize costs had individuals not been compensated by Florida Power & Light for assistance following Hurricane Andrew. Consistent with the above, the Commission adopts the Consumer Advocate's adjustment of $6,000 annually to taxes other than income taxes.

N. Environmental Costs.

The Staff, in prefiled testimony, did not allow a return on the unamortized balance of environmental costs. The Company, as per the stipulation, has agreed with Staff in this instance due to the pro forma nature of this adjustment. The Consumer Advocate also agrees. The Commission concurs with all parties.

O. Capacity Purchase from Carolina Power & Light Company.

The Staff and Company have included the costs associated with the contractual obligation entered into by the Company for capacity purchases and, therefore, would recommend a $1,732,000 annual expense in O&M expenses. The Consumer Advocate has rejected this adjustment.

In August of 1991, South Carolina Electric & Gas Company signed a purchase power contract with Carolina Power & Light Company for 100 megawatts of capacity to be provided in the summer months of 1993 and 1994. As reflected in the Company's integrated resource plan which was recently addressed by this Commission, the Company has adopted the strategy of using purchased power contracts including the Carolina Power & Light Contract to meet capacity shortfalls pending completion of its new coal-fired base load plant at Cope, South Carolina. The Company maintains a target capacity margin of 20% as testified to by Company witness Addison, with Carolina Power & Light Company purchases as necessary to maintain the capacity margin near, but slightly below, the Company's 20% target pending completion of the Cope facility.

These capacity purchase expenses, in as much as they are supported by a binding contract between SCE&G and Carolina Power & Light Company are known and measurable expenses that will be incurred by the Company during the time that these rates are in effect. Consumer Advocate's witness Miller agrees, but is concerned that if this expense is built into rates without provisions for future adjustments, that their impact may continue until after the contract has expired.

The Commission, however, does not see the need for any special treatment of these expenses. The need for the capacity to be purchased from all other system sources will exist until the Cope plant comes on line in 1996. As explained in the testimony of Company witness Kenyon, demand on SCE&G's system continues to grow at approximately 1.8% per year. In addition to the 100 megawatts to be purchased from Carolina Power & Light Company in 1993 and 1994, the Company will purchase an additional 50 megawatts of capacity from other suppliers in 1994 and an additional 250 megawatts of capacity in 1995 (TR. Vol. 2, at 69). As a result, the expenses associated with the purchase of 100 to 350 megawatts of capacity from outside sources will be borne by the Company until 1996.

In 1996, it is anticipated that these purchases will cease and the Cope generating station will be placed in rate base if approved by the Commission. At that time, the Company's expenses will increase by the full amount of depreciation, taxes, operating and maintenance expenses and other expenses related to this new $450 million facility. While the cost related to off system purchases are expected to disappear at this time, they will be more than offset by the cost associated with this new long-term source of supply.

Accordingly, the Commission finds that there is no reason for any special adjustment to recognize the temporary nature of the Carolina Power & Light Company capacity purchase agreement. While the specific agreement may be temporary, the need for the additional capacity is not, and the Company will incur expenses at or above the level of the 100 megawatt purchase power contract for the foreseeable future.

P. Post-Retirement Benefits Other than Pensions.

Staff and Company in prefiled exhibits have utilized the accrual method of accounting for post-retirement benefits other than pensions. This treatment is consistent with the Commission's decision in recent rate proceedings. Consumer Advocate witness Miller has recommended the pay-as-you-go methodology. The Commission approves a $4,011,000 annual expense for these benefits. The Staff and Company have also agreed per the stipulation that should this liability be funded externally, then a reduction from rate base is not appropriate. Conversely, if the liability is funded internally, a reduction of $2,515,000 is appropriate.

As stated in the testimony of the Company's witness Addison, in December 1990, the Financial Accounting Standards Board issued Statement No. 106 (SFAS 106) entitled, "Employer's Accounting for Post-Retirement Benefits Other Than Pensions." That directive states that, effective January 1, 1993, the cost of post-retirement benefits other than pensions must be accrued during the years that employees render the service creating eligibility for the applicable benefits.

Before SFAS 106, the costs of these benefits were booked on a pay-as-you-go basis. Under this treatment, expenses for these benefits were recognized only as employees submitted claims for the benefits in question after retirement.

As the evidence in the case points out, this traditional pay-as-you-go treatment is inconsistent with the treatment that has been afforded to the actual pension benefits themselves. For years, utilities have been required both by regulators and the accounting community to book the value of future pension benefits during the time when the eligibility for those benefits is being earned.

The Company and Staff propose to adopt the requirements of SFAS 106 for both regulatory and accounting purposes. This will result in the Company booking additional expenses on an ongoing basis for the post-retirement cost other than pensions of the employees presently serving its customers.

In addition, SFAS 106 requires the Company to recognize a "transition obligation." This is the amount of the accrual required to recognize SFAS 106 obligation existing, but not previously recognized, on January 1, 1993. In effect, the transition obligation is the amount of money necessary to bring the Company current as of January 1, 1993 for its SFAS 106 liability. The amount of this transition obligation is $60,693,000 on a retail basis. SFAS 106 allows the Company to amortize the amount of the transition obligations over a period of not more than twenty (20) years. The Company proposes to use a full twenty year period for the amortization of this obligation.

The Consumer Advocate, through his witness, Mr. Miller, argues that the Company should continue using the pay-as-you-go method for these obligations. Mr. Miller states that the adoption of SFAS 106 does not reflect current service costs and exacerbates intergenerational inequities.

Based on the testimony of Company witness Addison, the Commission finds that the Company's proposed SFAS 106 treatment results in the least possible intergenerational inequity (TR. Vol. 6, at 55). As set forth in that testimony, the bulk of SFAS 106 are costs applicable to current periods. The transitional costs relate to prior services, but as pointed out by witness McClellan, "current customers have benefited more than future customers from the services responsible from the transition costs." (TR. Vol. 6 at 56).

The Commission agrees that the SFAS 106 treatment of transition costs places the burden of those costs closer to the benefits received than the pay-as-you-go method proposed by Mr. Miller. Furthermore, the pay-as-you-go method sends inaccurate price signals. Under it, customers receive the benefit from employees' efforts today, but defer the full cost of those employees' compensation until future years. This drives the price of service today below its true cost and may eventually increase the price of future service above its true cost.

In this case, the logic that leads the accounting community to adopt SFAS 106 as a financial accounting standard is applicable with equal force to the question of whether it should be adopted as a regulatory standard. The Commission determines that SCE&G should implement SFAS 106 as proposed by the Staff and the Company.

Consumer Advocate witness Miller also argues that SFAS 106 costs are not known and measurable costs since they reflect future expenses measured by actuarial data. Actuarial data is routinely used in setting test period expenses for regulatory purposes. It is particularly appropriate to use actuarial data where liabilities are incurred in one period for expenses to be paid in future periods. This, in fact, is the method by which ordinary pension accruals are measured. The use of actuarial data is appropriate to these circumstances, particularly given the fact that SFAS 106 accrual levels, like pension accruals, can be reviewed on a year by year basis, and adjusted according to new data. The use of actuarially based accruals is also justified here as a practical necessity. The only alternative to actuarial based accrual is the pay-as-you-go methodology which results in a significant understatement of the cost of service, and an improper shifting of current costs to future customers.

The Consumer Advocate's witness. Mr. Miller, requests alternatively that the Company be ordered to establish independent third party trusts for deposit of these SFAS 106 accruals. The Commission does not find it necessary to mandate the creation of such a trust at this time. In some cases, a better return on accrued assets can be obtained by internally reinvesting such funds within a Company rather than by relying on external trusts. Internal investment can reduce administrative costs and in some cases can allow the Company to earn a more favorable return on these amounts than can be earned through the restrictive investment options available to third party trusts. These additional earnings, in some cases, can reduce the required accruals and the resulting burden on the customers. The Commission will continue to monitor the treatment of these amounts and in future cases will make any adjustments to the present treatment that the facts require.

As further support for the Commission ruling on SFAS 106, the Commission notes that as set forth in the testimony of Company witness McClellan, the Company is under a mandatory obligation to book SFAS 106 liabilities without regard of the rate treatment of cost. (TR. Vol. 5, at 62) Only by allowing rate recovery for these costs as set forth herein will a Company's costs and revenues match. Using any other method, the SFAS 106 expense will have to be booked, but rates will not create the revenues necessary to cover those expenses. As a result, the Company's earnings will suffer. This will increase the cost of capital to the Company and in the long term, increase the rates that it must charge its customers.

Inasmuch as the Company is not proposing to externally fund its SFAS 106 liabilities at this time, these liabilities in the amount of $2,515,000 are properly deducted from retail rate base. This deduction reflects the fact that the Company has interest free use of the funds. The resulting rate base deduction creates benefits for customers by reducing the amount of capital that customers must support through present rates.

The remaining issue with regard to SFAS 106 and post-retirement benefits concerns the treatment of SFAS 106 amounts that have accrued between January 1993 and May 1993. As mentioned above, the Financial Standards Board has required the Company to implement SFAS 106 as of January 1, 1993. Since the rates approved in this Order will not go into effect until June 1993, the amounts accrued during the interim must be properly accounted for. The Staff and Company have agreed in the Staff's Stipulation at page 3 to add these amounts to the transition obligation and amortize them over the twenty (20) year period applicable to that obligation. The Company had previously proposed to amortize those amounts over only two years. The Commission finds that the proposal to increase the amortization period to twenty (20) years reduces rate impact on customers and properly accounts for this aspect of the SFAS-106 obligation.

Q. Property Tax Expense.

The Staff and Company have included the cost of property tax which will be incurred associated with amounts closed to plant in service from CWIP. Although witness Miller originally recommended not closing these amounts to plant-in-service, therefore, requiring no property tax adjustment, the Consumer Advocate agreed in his brief with the Staff and Company. Therefore, the Commission approves an adjustment of $3,067,000 annually to O&M expense.

R. CWIP Closed to Plant.

The Company and Staff per the stipulation have agreed to the inclusion of CWIP completed as of February 24, 1993, into Plant In Service. Although Consumer Advocate witness Miller included CWIP completed at the end of the test year, in the Consumer Advocate's brief, he subsequently agreed with the Company and the Staff, therefore, the Commission approves the amount of $121,271,000.

S. Unclaimed Funds.

The Company and Staff have agreed per the stipulation to reduce rate base by $37,000 to reflect non-investor supplied funds. Consumer Advocate witness Miller has utilized a thirteen month average at arriving at his calculation of $71,000. The Commission has examined this matter and believes that the adjustment recommended by the Staff and the Company is appropriate in this case.

T. Cash Working Capital Methodology.

The Commission Staff and Company have calculated the cash working capital requirement based on the formula method as approved by this Commission in all recent electric rate proceedings. The Consumer Advocate has recommended that the Commission include a zero cash working capital allowance, based on the failure of the Company to file a lead-lag study. In addition, Mr. Miller recommends that the Commission initiate a generic proceeding to consider the use of lead-lag studies.

In this case, the Company computed its cash working capital requirements using a formula based on one-eighth of non-fuel O&M expense of the Company with certain adjustments. This one-eighth formula is a standard formula used in utility regulation to determine the amount of cash utilities must have on hand to support working capital requirements. The one-eighth formula is the prevailing method used by regulators nation-wide to measure cash working capital requirements. (TR. Vol. 5, at 42) In Order No. 89-588, entered in Docket No. 88-681-E, the Commission noted that SCE&G's lead-lag study performed in that docket did not provide a better approximation of cash working capital needs than the one-eighth formula. The Consumer Advocate's witness Mr. Miller argues that the Commission should abandon the one-eighth formula in favor of specific lead-lag studies to be conducted at regular intervals. A lead-lag study attempts to quantify cash working capital requirements by studying the delay between the date the utility service is rendered, and the date payment is received and the delay between the utility's receipt of bills or expenses and the payment of those bills by the utility.

The Commission agrees with the position advanced by Company witness McClellan and Staff witness Price that the one-eighth formula is a proper means to determine cash working capital. One reason is practicality. The lead-lag study is extremely complex and expensive. A utility company, like SCE&G, generates millions of bills for services each year and pays thousands of bills from suppliers. If the Commission were to order lead-lag studies, SCE&G's customers would ultimately pay the cost of them. Moreover, the outcome of the studies is very much dependent on the assumptions used in labeling and tracking expenditures. On the other hand, as Company witness McClellan testified, utility companies are uniquely well-suited for application of a standard formula for cash-working capital purposes. The lag in income receipt is generally a very consistent 35 to 40 days among utility companies. Moreover, as Company witness McClellan also testified, most electric utilities have consistent patterns of payroll payments, fuel payments and income tax payments, all of which are substantial determining factors in lead-lag results related to expenses. The one-eighth formula has been applied for years to determine cash-working capital requirements. McClellan testified from his own experience that it provides a reasonable and workable proxy for a detailed lead-lag study.

In short, the evidence supports a conclusion that the customers would not receive adequate benefits from a detailed lead-lag study to offset the additional expense. The Commission sees no need to deviate from its established policy of relying on the one-eighth formula.

Mr. Miller also states that, in his opinion, a properly conceived lead-lag study would show that companies like SCE&G do not have any need for cash-working capital. As pointed out by Company witness McClellan, what is typically meant by a properly conceived lead-lag study is one that omits significant investor capital support requirements. As witness McClellan also testified, what this most often means is that the study does not take into account the lag between the billing and receipt of funds necessary to pay for depreciation and capital costs. Such an analysis ignores the fact that the Commission has authorized depreciation of capital costs to be billed and collected on a monthly basis as service is rendered. Delays in remitting cash to cover these requirements are properly considered in a lead-lag study. Accordingly, the Commission places no weight on Mr. Miller's assertion that a properly conceived lead-lag study would result in a zero cash working capital allowance. Instead, the Commission finds that the one-eighth formula properly estimates cash working capital for South Carolina Electric & Gas Company in this proceeding. The Commission also denies the Consumer Advocate's request for a generic proceeding to consider the use of the lead-lag study for the reasons stated above.

U. Lobbying Expenses.

In a response to the Consumer Advocate's Interrogatory No. 1-40, the Company admitted that it incorrectly charged a portion of its lobbying expense above the line. TR. Vol. 6, at 105. The Company and Staff agrees with the Consumer Advocate's position on this matter. TR. Vol. 4, at 69-70. The Company's test year operation and maintenance expense should be reduced by $19,822, on a system basis. See, Hearing Exhibit 28, Schedule 3.11.

V. Miscellaneous Adjustments.

The Staff has identified a total of $145,000 in miscellaneous adjustments to O&M expenses related to items such as the sponsorship of sports teams by SCE&G, general advertising expenses not properly recoverable in rates, and other miscellaneous items. As set forth in Staff Stipulation at page 4, SCE&G agrees to the reduction of its O&M expenses by these amounts. The Commission approves this adjustment.

W. Cope Construction Work in Progress.

As mentioned above, the Company is in the process of constructing a new base load coal-fired generating facility in Cope, South Carolina. By the end of May 1994, the investment in this project is expected to be $243,020,917. As stated by Company witness McClellan, the project is being built under what is essentially a fixed-price contract; it requires pre-scheduled payments by the Company to Duke/Flour Daniel. TR. Vol. 6, at 8, 39. The Commission finds as set forth in the testimony of Company witness McClellan, that the Company's expenditures on the the Cope Plant are known and measurable, and are not speculative in that these expenditures are committed pursuant to the Duke/Flour Daniel contract for a project which the Commission has previously reviewed and approved in Docket No. 91-606-E.

In past cases, the Commission has allowed utilities to make adjustments to rate base for construction work in progress or CWIP. See, Order No. 89-588 in Docket No. 88-681-E. By allowing CWIP in rate base without offset for allowance for funds used during construction or AFUDC, the Company is allowed to recover in current rates its carrying costs on the investment and facilities under construction.

The record contains testimony by Company witnesses McClellan and Brigham supporting the inclusion of CWIP in rate base without AFUDC income offset. As stated in that testimony, this CWIP treatment creates multiple benefits for the Company and its customers. It reduces total costs to the construction projects by reducing the amount of carrying costs booked to them in the form of AFUDC. When CWIP is allowed without AFUDC offset, the result is that customers begin paying part of the financing cost of the project while construction is ongoing. As a result, when the plant is completed and added to the rate base, the total costs are greatly reduced. For this reason, where CWIP is allowed, rates upon completion of the plant, are never as high as they would have been had CWIP not been included, and had full AFUDC costs during the construction been added to the final cost of the plant. Allowance of CWIP without AFUDC offset creates a number of other benefits for utility customers. The rate shock that can occur when a new plant is added to rates is reduced because of the smoothing effect of incremental rate increases while the plant is being constructed. Not only does this minimize rate shock, inclusion of construction also sends better pricing signals to customers during the construction phase.

Another benefit of this CWIP treatment is the effect it has upon the Company's overall cost of capital. Inclusion of CWIP in rate base allows the Company to began earning a cash return on the amount spent on a plant during the construction period. These are real dollar returns that are recognized as such by the investment community. When calculating coverage ratios and other financial indicators for utility companies, investors routinely subtract the paper earnings related to the booking of allowance for funds used during construction, which reflect a mere expectation that rate recovery of the funds they represent will occur in the future.

In addition, CWIP treatment of the sort proposed here is a signal of regulatory support to the investment community for the project in question, which should reduce the overall cost of capital to the Company, and over the long-term, reduce the rates that the Company must charge its customers.

In order to recognize the inclusion of $229,778,576 on a South Carolina electric retail basis associated with the Cope Plant in rate base, the Company proposes to breakdown its proposed increase of $72.2 million dollars into two steps. The first increase which the Company refers to as an interim increase of $57.3 million dollars would take into account the portion of the Cope CWIP completed as of May 31, 1993. This amount was estimated to be $88,900,576 on a jurisdictional basis. The second increase of $19.0 million takes into consideration the additional Cope CWIP expected to be completed as of May 1994. This amount is estimated to be another $140,878,000 on a South Carolina retail basis. The Consumer Advocate initially opposed the inclusion of any Cope CWIP beyond that which had been completed as of the commencement of the hearing. TR. Vol. 6, at 46-55. The Staff agreed with the Company concerning the inclusion of the estimated Cope CWIP in rate base. Hearing Exhibit 33, at 15.

The Consumer Advocate recommended in his brief that the Commission approve final rates, including Cope CWIP of $228,208,208 for South Carolina retail operations.

The Staff and Company in prefiled exhibits included actual retail CWIP through September 30, 1992 of $42,643,897 and projected retail CWIP through May 31, 1993 of $46,256,679 based on the contractual obligation. The Consumer Advocate witness Miller, in prefiled exhibits, proposed to include only those payments made at the end of the test year. After further review of the matter, the Staff has recommended that the Commission include verified actual payments through May 31, 1993 of $87,330,208 as retail Phase I CWIP. With regard to retail CWIP Phase II, Staff and Company both recommended that $140,878,000 be included in CWIP. The Consumer Advocate originally disagreed, but in his brief, agrees with the Staff recommendation that, prior to rates for Phase II being placed into effect on June 1, 1994, that actual Cope expenditures be verified using a methodology similar to that prescribed by Staff.

The Staff and Company in prefiled exhibits included projected contractual amounts for CWIP for the period June 1, 1993 through May 31, 1994. Staff has recommended that should the Commission adopt this phase-in approach, that the Commission require the Company to provide monthly reports concerning actual progress payments, and instruct the Staff to audit these reports on a quarterly basis. Staff has also recommended that the Company not be allowed to implement Phase II of this rate case until the $140,878,000 is actually expended and verified, as set forth below.

For the reasons stated above, and in the testimony of Company witnesses McClellan and Brigham, Consumer Advocate witness Miller, and Staff witness Price, the Commission hereby approves final rates, including Cope CWIP of $228,208,208 for retail electric operations. The Commission, however, agrees with the Consumer Advocate and the other parties, that it should not allow the Company to charge rates reflecting the full amount of this Cope CWIP until all such funds have actually been expended. Accordingly, the Commission will delay the effective date of rates reflecting the full $228.2 million in Cope CWIP until the first billing cycle of June 1994, or such later date as the Commission has verified that the total of $228,208,208 has been booked into the Cope CWIP account. Until such time as final rates become effective, the Commission orders the Company to charge interim rates reflecting Cope retail CWIP expenditures of $87,330,208, that amount being the amount having been spent as of May 31, 1993.

Until such time as the final rates are implemented, the Commission further requires the Company to provide monthly reports to the Commission, and to any of the parties who so request. These reports shall detail (a) payments during that month under its contract with Duke/Flour Daniel for construction work on the Cope Plant; (b) major milestones in construction on the Cope Plant reached during that month; and (c) accumulative balance in the Cope CWIP account at months end. The Staff shall audit these reports on a quarterly basis beginning with the quarter ending June 30, 1993, and report its findings to the Commission quarterly. While the adjustment to final rates is pending, the Company shall provide the parties all such information as a party shall reasonably request concerning the construction status of the Cope Plant and the amounts included in the Cope CWIP account.

The Commission also retains jurisdiction to delay the effective date of the final rates and to conduct further proceedings concerning them should it appear (a) that there has been a material adverse departure from the construction plan or payment schedule for the Cope Plant; (b) that material problems have arisen in the Cope Plant construction that jeopardize the used and useful nature of the expenditures to date; or (c) the Cope Plant has suffered a material casualty loss which jeopardizes its eventual completion. Upon application of any party to this Docket, the Commission may order hearings upon the matters set forth in subparts a, b, or c above should it appear that any of the matters set forth therein have occurred.

X. Nuclear Decommissioning.

The Company and Staff have included an adjustment to annualize nuclear decommissioning expense in the amount of $1,508,000. The Consumer Advocate did not address this issue during the proceeding, though he did address the issue in his brief. The Consumer Advocate urges that the Commission adopt the NRC's minimum requirement, which would result in no need for the annualized adjustment. Upon consideration of this matter, the Commission adopts the Company and Staff's adjustment of $1,508,000 to annualize nuclear decommissioning expense. The revised nuclear decommissioning study supplied by SCE&G supports this figure. The Commission, therefore, adopts this adjustment.

Y. All Other Adjustments.

The Commission holds that all other accounting and *pro forma* adjustments proposed by, or agreed to by the Staff and not objected to by any other party are hereby approved. Further, all other adjustments proposed by various parties, and not agreed to by the Staff not specifically addressed herein, have been considered by the Commission and are denied.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NO. 11

Pursuant to *S.C. Code Ann.*,§58-27-180 (1976), the Commission has the authority after hearing to "ascertain and fix" the value of the property of an electrical utility. In the context of a ratemaking proceeding, such authority is exercised in the determination of the electrical utility's rate base.

For ratemaking purposes, the rate base is the total net value of the electrical utility's tangible and intangible capital or property value on which the utility is entitled to earn a fair and reasonable rate of return. The rate base, as allocated or assigned directly to SCE&G's retail electric operations, is composed of the value of SCE&G's property used and useful in providing retail electric service to the public, plus net nuclear fuel, construction work in progress, materials and supplies, and allowance for cash working capital. The rate base computation incorporates reductions for the reserve for depreciation and amortization, accumulated deferred income tax and customer deposits. In accordance with its standard practice, the Accounting Department of the Commission Staff conducted an audit and examination of SCE&G's books, and verified all account balances from SCE&G's General Ledger, including rate base items, with plant additions and retirements. On the basis of this audit, the pertinent hearing exhibits, and the testimony contained in the record of the hearing, the Commission can determine and find proper balances for the components of SCE&G's rate base, as well as the propriety of related accounting adjustments.

For ratemaking purposes, the Commission has traditionally determined the appropriate rate base of the affected utility at the end of the test period. This Commission's provision for the determination of a utility's rate base on a "year end" basis likewise serves to enhance the timeliness of the effect of such action, and preserves the reliance on historic and verifiable accounts without resort to speculative or projected figures. Consequently, the Commission finds it most reasonable to retain its consistent regulatory practice herein and evaluate the issues of this proceeding founded on a rate base for SCE&G's retail electric operations as of September 30, 1992.

When the rate base has been established, SCE&G's total operating income for return if applied to the rate base to determine what adjustments, if any, to the present rate structure are necessary to generate earnings sufficient to produce a fair rate of return. The rate base should reflect the actual investment made by investors in SCE&G's property and the value upon which stockholders will receive a return on their investment.

With respect to the record in the instant proceeding, only certain rate base issues were contested by the parties of record. Those issues related to plant in service and construction projects, and to the methodology for computation of working capital. The Commission hereby adopts the following as the Company's rate base:

TABLE B

ORIGINAL COST RATE BASE
RETAIL ELECTRIC
SEPTEMBER 30, 1992
(000's)

	After Phase I	After Phase II
Gross Plant in Service	$2,899,584	$2,899,584
Accumulated Depreciation	(860,418)	(860,418)
Net Plant in Service	2,039,166	2,039,166
CWIP	164,332	305,210
Accumulated Deferred Income Taxes	(380,158)	(380,158)
Materials and Supplies Inventory	94,677	94,677
Cash Working Capital Allowance	29,459	29,459
Total Original Cost Rate Base	$1,947,476	$2,088,354

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 12

The Company proposed a capital structure consisting of 47.80% long-term debt, 4.26% preferred stock, and 47.94% common equity. This was the capital structure as of September 30, 1992, adjusted for the Company's November 1992 common equity offering. In his prefiled testimony, the Consumer Advocate witness Legler acknowledged the reasonableness of the adjustment, but recommended that the adjustment process should be extended to debt and preferred stock. Essentially, both the Company and Legler are recommending that the capital structure be updated to various extents. The Commission Staff, in fact, utilized the capital structure and embedded cost rates for long term debt and preferred stock as of December 31, 1992. The uncertainty in this matter can be removed by the adoption of the actual capital structure as of December 31, 1992, as reported in Hearing Exhibit No. 33. The actual capital structure as of December 31, 1992 consists of 47.95% long-term debt, 4.21% preferred stock, and 47.84% common equity. The Commission adopts this capital structure for purposes of calculating the weighted average cost of capital in this proceeding.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 13

The Company proposes a cost of long-term debt of 8.33%, the actual embedded cost rate as of September 30, 1992. Based on the Company's response to the Commission's Information Data Request 1-3, Consumer Advocate witness Legler recommended that the cost rate as of the end of November 1992 be used. See Hearing Exhibit No. 37 (1 through 3). That cost rate was 8.31%. Dr. Legler recommended that this cost rate be updated if possible. The Staff Report provides an updated figure of 8.29%. Based on this evidence, the Commission adopts the rate of 8.29% for purposes of calculating the weighted average cost of capital in this proceeding. The Company proposes the use of an embedded cost rate of 7.71% as of September 30, 1992 for preferred stock. Dr. Legler made adjustments to this cost rate for changes made between September 30, 1992 and the end of November 1992, and proposed a cost rate of 7.70%. The Commission Staff places the embedded cost of preferred stock at 7.70%. As a practical matter, there is virtually no difference in the cost of preferred stock proposed by the parties. The Commission, therefore, adopts a cost rate of 7.70% for preferred stock in this proceeding.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 14

The most controversial issue of the cost of capital is the return on common equity. In this case, the Commission heard the expert testimony of four witnesses on this issue. Dr. Eugene F. Brigham, a Graduate Research Professor of Finance and Director of Florida's Public Utility Research Center at the University of Florida, testified on behalf of South Carolina Electric & Gas Company. Dr. James E. Spearman, the Assistant Public Utilities Economist for the Commission Staff, appeared on behalf of the Staff. Dr. John B. Legler, Professor of Banking and Finance of the University of Georgia, appeared on behalf of the Consumer Advocate. In his prefiled testimony, Dr. Brigham recommended that the Company be authorized to earn an equity return of 12.5% to 13.7%. His point recommendation was 13.1%, which included a factor for the recovery of common equity floatation costs. At the time of his appearance, Dr. Brigham updated his estimates and recommended a range of 12.0% to 13.0%. This range included a floatation cost allowance of 30 basis points and Dr. Brigham stated that if such an allowance is excluded, the range would be 11.7% to 12.7%. (TR. Vol. 3, Brigham at 97-98). Dr. Brigham stated that if CWIP is included in the rate base, it would be appropriate to authorize a lower end of this range to 12.0%. If floatation costs are not allowed, the return should be set towards the middle of this range of 11.7% to 12.7% (TR. Vol. 3, Brigham at 98).

The Consumer Advocate believes that the issue of CWIP and floatation costs are distinct and separate. Essentially, adopting a rate of 12.0%, if the lower end of the range is appropriate, amounts to allowing a floatation cost allowance. This Commission has, for a number years, treated the floatation cost allowance on a case by case basis and has a good record of consistency. The Commission has allowed a floatation cost adjustment when it was warranted by either recent stock offering or a prospective offering. The Consumer Advocate has recommended in this case, through his brief, that the Commission continue its record of consistency in this regard.

All three cost of equity witnesses recommend the adoption of a floatation cost adjustment in this case. The only difference is in the magnitude of the required adjustment. Dr. Brigham recommends the adoption of a thirty basis point adjustment (TR. Vol. 3, Brigham at 98). Dr. Spearman recommends the adoption of a thirteen basis point adjustment (TR. Vol. 6, Spearman at 279). Dr. Legler recommends the adoption of a ten basis point adjustment (TR. Vol. 8, Legler at 112-113). The primary reason for the difference between Dr. Brigham's recommendation and those of Drs. Spearman and Legler has to do with equity component to which the adjustment should be applied. Both Drs. Spearman and Legler limit the adjustment to externally raised equity based on the Company's own record of common stock issuance. Dr. Brigham applies the adjustment to the Company's entire equity balance. The Consumer Advocate has stated in his brief that the adjustments proposed by Drs. Spearman and Legler are more consistent with the policy of this Commission and should be adopted and that the three basis point difference in their recommendations is of very minor significance in the calculation in the weighted average cost of capital.

In arriving at what constitutes a fair return on equity, the Commission applies the principal set forth in Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591, 602-603 (1944); and Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 692-73 (1923), as adopted by the South Carolina Supreme Court and Southern Bell Telephone and Telegraph Company vs. South Carolina Public Service Commission, 270 S.C. 590, 244 S.E.2d 278 (1978). These cases provide that a fair rate of return for a utility must be one that is commensurate with returns on investments and other enterprises with similar risks which is adequate to ensure the confidence of financial markets; and which is adequate to allow the Company to maintain its credit worthiness and to allow it to attract new capital at reasonable terms. Id.

In assessing what constitutes a fair rate of return, certain financial models and methods of analysis are used to measure historical or expected costs of capital. Each of these models has its strengths and weaknesses. By law, the Commission is not required to use any single formula or combination of formulas in calculating costs of capital. Id.

Furthermore, it is pointed out by Company witness Brigham, there is a difference between cost of capital which is measured by these formulas and a fair rate of return. The decision as to what constitutes a fair rate of return involves a balancing of investor and customer interest in the exercise of expert judgment by the Commission. As a matter of regulatory policy, it is appropriate to consider the efficiency of a company in determining at what point within a general range of reasonableness its rates of return must fall. In fact, there is statutory authority under S.C. CODE ANN. §58-27-970 (1976, as amended) which allows utilities to participate in profits arising from efficiencies they have received. Accordingly, the use of these formula-based analysis techniques is in all cases subject to the expert judgment of the Commission as to factors not reflected in them.

The Company's first witness concerning rate of return was Charles Schreiber, an investment banker and Managing Director of the Utility Finance Division of Payne-Webber, Inc. Schreiber's testimony focused on the earning investors would expect to support a strong single-A bond rating for the Company. Schreiber began his testimony by noting that the Company is embarking on a new construction cycle which will result in the Company expending approximately $3 billion in new capital over the next ten years. According to Schreiber, to maintain a strong single-A bond rating and reasonable access to capital markets during this period. The

Company should maintain debt coverage ratios in the range of 3.5 to 4.0 times earnings. Mr. Schreiber testified that to support the required 3.5 times earnings, the Company would have to have an earned return on equity of 12.28%.

The Commission finds Schreiber's testimony to be credible and that it should be weighed along with the testimony of witnesses using other models and methods in determining a proper return on equity.

Dr. Eugene Brigham, Graduate Research Professor of Finance at the University of Florida and Director of Florida's Public Utility Research Center, presented the results of calculations made using four methods to estimate the Company's cost of equity. He used the DCF method, the capital asset pricing model method based on historical data (the historical CAPM), the capital asset pricing model based on expected future data (the expected CAPM), and the risk premium method. He checked them against comparable earnings for the top 50 utilities and the top half of the Saloman Brothers Index of 97 publicly traded utilities (TR. Vol. 3, Brigham at 69).

Dr. Brigham's initial analysis, based on December 1992 data, resulted in a recommendation that the Company be authorized to earn a return on equity in a range of 12.5% to 13.7%. Brigham updated his analysis based on data available at the time of the hearing and revised his range from 12% to 13%. That range included a floatation adjustment of 30 basis points, which if disallowed, would reduce the range from 11.7% to 12.7%. Brigham's results for individual models were as follows:

DCF	12.0%
Historical CAPM	12.2%
Expected CAPM	12.6%
Risk Premium	13.3%
Average	12.5%
Comparable Earnings	13.13%

(TR. Vol. 3, Brigham, at 99).

Based on Brigham's analysis and the testimony presented by the other parties, the Company, by letter dated March 25, 1993 informed the parties that it would reduce its requested return on equity to 12.0%, not including earnings related to DSM expenditures. Both Dr. Brigham and Mr. Schreiber testified that they could support a 12.0% return on equity for the Company, not including earnings related to the DSM expenditures.

The Consumer Advocate's rate of return witness was Dr. John B. Legler, Professor of Banking and Finance in the Terry College of Business at the University of Georgia, Athens, Georgia. Like Dr. Brigham, Dr. Legler used a range of methods to analyze cost of equity capital and produce the results in the following ranges:

DCF Method	9.5% - 11.7%
Premium Method	8.65% - 11.33%
Capital Assets Pricing	10.02% - 11.64%
Comparable Earnings	11.2% - 12.0%
Recommended	11.00% - 11.5%

(TR. Vol. 8, Legler, at 115-116).

The Commission Staff presented the testimony of Dr. James Spearman, Assistant Public Utilities Economist of the South Carolina Public Service Commission. Dr. Spearman used the discounted cash flow method based on dividend growth, the discounted cash flow method based on earnings growth and the historical CAPM. Dr. Spearman's results are as follows:

DCF Dividend Growth	8.77% - 9.84%
DCF Earnings Growth	9.52% - 11.22%
CAPM	9.66% - 11.73%
Recommended	11.00% - 11.5%

(TR. Vol. 5, Spearman, at 292).

All witnesses agreed, based on the Company's recent stock issuances and plans for future stock issuances, to support its construction program, that floatation adjustments were appropriate in this case.

The differences between the experts' assessments of the Company's capital costs for equity were based on multiple assumptions they have made within each model to best reflect, in their opinion, investors' expectations. None of the assumptions made are, per se, unreasonable and each analysis is properly weighed in analyzing a reasonable return on equity for the Company. In as much as various forms of the models are used and assumptions are made within each model, the Commission must review the adjustments and assumptions in toto and compare them with its own expert judgment as to the earnings requirements of investors at this point in time.

In this regard, there are several factors which guide the Commission's exercise of its judgment in this case. First, the country is in a period of atypically low interest rates as explained by witness Brigham in such context. The Commission agrees with the Company's position that at this time a strong A-bond rating is an important goal for the Company because it can reduce overall capital costs to customers.

In explaining why he had set his cost of capital in the upper end of his range of reasonableness, Dr. Legler stated the following:

> My usual recommendation is to set the cost of equity at the midpoint of my range in the absence of reasons to do otherwise. In this case, I will base my weighted average cost of capital on the upper end of my range, 11.5%. We are all aware of the expression rate shock as a reason for not moving rate cases too quickly. In fairness, the current financial markets may well cause investor shock if the Commission were to set the allowed return strictly on the basis of financial model results. (TR. Vol. 8, at 117).

Based on the evidence before it, the Commission adopts the range of rate of return between 11.5% to 12%, with rates to be set at 11.5%. This range combines the high range of Drs. Spearman and Legler with the rate of return recommended by Dr. Brigham. Both numbers fall within the range of rates recommended to this Commission by the various witnesses. These numbers also result in the coverage ratios (3.0x-3.5x) recommended by Company witnesses Timmerman and Schreiber as necessary to maintain a strong A-bond rating. Also, the Commission believes this range will encourage the Company to seek efficiencies in operation and construction during this period of high capital expenditures. In using its discretion and judgment, this Commission believes that rates in this case should be set at 11.5%, which is consistent with the recommendations of Drs. Spearman and Legler. This range properly accounts for Dr. Legler's concern with investor shock, which is a matter of particular importance, given the Company's need to raise hundreds of millions of dollars in additional capital to complete the Cope plant and immediate benefits to customers of strong bond and stock prices while this capital is being raised.

OVERALL RATE OF RETURN

The ratemaking process requires the determination of the overall rate of return which the utilities should be allowed the opportunity to earn. This Commission has utilized the following definition of rate of return in previous decisions and continues to do so in this proceeding.

> For regulatory purposes, the rate of return is the amount of money earned by a regulated company over and above operating costs expressed as a percentage of the rate base. In other words, the rate of return includes interest on long-term debt, dividends on preferred the earnings on common stock and surplus. As Garfield and Lovejoy have put it, the return is that money earned from operations which is available for distribution among the various classes of contributors of money capital. In the case of common stockholders, part of their share may be retained as surplus.
> Phillips, The Economics of Regulation, pages 260-261 (1969).

The amount of dollars permitted to be earned by the Company through the operation of its rate structure depends upon the jurisdictional rate base and the allowed rate of return on the rate base. Although the determination of the return on common equity provides the necessary component from which the rate of return on rate base can be derived, the overall rate of return to, as set by this Commission, must be fair and reasonable.

The United States Supreme Court, in the decision of Bluefield Water Works and Improvement Company v. Public Service Commission of West Virginia, supra, delineated general guidelines for determining the fair rate of return in the utility regulation. In the Bluefield decision, the Court stated:

> What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment. Having regard to all the same general part of the country on investments and other business undertakings which are attended by a corresponding risk and uncertainties; but has no constitutional rights to profits such as are realized and anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate under efficient and economical management, to maintain and support its credit and enable it to raise money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time, and become too high or too low by changes affecting opportunities for investment, the money market, and business generally. 262 U.S. at 692, 693.

During the following years, the Supreme Court refined those precepts and in the landmark court decision, the Court restated its views:

> We held in Federal Power Commission v. Natural Pipeline Gas Company...that the Commission was not bound to the use of any single formula or a combination of formulae in determining its rates. Its ratemaking function, moreover, involves the making of pragmatic adjustments. (cite omitted)...Under the statutory standard of just and reasonable, it is the result reached, not the method employed, which is controlling (cites omitted)...
>
> The ratemaking process under the Act, i.e., the fixing of just and reasonable rates involves the balancing of the investor and the consumer interests. Thus, we stated in the natural gas pipeline company case, that regulation does not ensure that the business shall produce net revenues (cite omitted). With such considerations aside, the investor-interest has a legitimate concern with the financial integrity of the Company whose rates are being regulated. From the investor or company point of view, it is important that there be enough revenue not only for operating expenses, but also for the capital costs of the business. These include service on the debt and dividends on the stock.

> (cite omitted). By that standard, the return to the equity owner should be commensurate with returns on investments and other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and to attract capital. 320 U.S. at 602, 603.

The vitality of these decisions has not been eroded as indicated by the language of the more recent decision of the Supreme Court IN RE: Permian Basin Area Rate Cases, supra. This Commission has consistently operated within the guidelines set forth in the Hope decision.

In consideration of these precedents, and utilizing the best judgment of the Commission, we hold that the Company's overall cost of capital shall be 9.80%.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 15

South Carolina Electric & Gas Company asks the Commission to allow it to earn a return on DSM expenditures equal to the Company's cost of equity. In effect, this treatment sets qualifying DSM expenditures on more of an equal footing with investment in additional plants and other supply side assets.

Title I, Subtitle B, Section 111(a)(8) of the Energy Policy Act of 1992 states:

> ...the utility's investment in and expenditures for energy conservation, energy efficiency resources, and other demand side management measures are at least as profitable, ..., as its investment in and expenditure for the construction of new generation, transmission, and distribution equipment. Such energy conservation, energy efficiency resources and other demand side management measures shall be appropriately monitored and evaluated.

Part IV, Chapter 37, Section 58-37-20 of the South Carolina Energy Conservation and Efficiency Act of 1992 states:

> The South Carolina Public Service Commission must adopt procedures that encourage electrical utilities... subject to the jurisdiction of the Commission to invest in cost-effective energy efficient technologies and energy conservation programs. These procedures must provide incentives and cost recovery for energy suppliers and distributors who invest in end-use technologies that are cost-effective, environmentally acceptable, and reduce energy consumption or demand. These procedures must allow energy suppliers and distributors to recover costs and obtain a reasonable rate of return on their investment in qualified demand-side management programs sufficient to make these programs at least as financially attractive as construction of new generating facilities.

The Commission interprets these Federal and state regulations to require that the Commission allow the utility to recover its direct expenditures and receive incentives for qualified DSM programs.

Certain criteria should be established, based on the testimony of Staff witness Walsh, for programs that will qualify for an incentive. For future direct DSM cost recovery and for future incentives, the Company must establish a process which will continually refine and enhance the methodologies used to estimate DSM impacts so as to properly verify energy savings achieved and to also identify the projected durability of such savings. Both the criteria and the incentive mechanism are subject to future modification as the Commission deems necessary. In any event, however, the following are hereby adopted by this Commission as the present criteria by which DSM programs of SCE&G may qualify for an incentive under this mechanism:

1) The Company must identify the specific DSM options which were in place during the test period.

2) Pilot projects do not qualify for an incentive.

3) Those DSM options which are load building should not be counted as part of the incentive. The options must reduce kilowatts (KW DEMAND) and/or kilowatt-hours to qualify for the incentive. Those options which might reduce peak KW but shift load to off-peak periods and thus increase kilowatt-hour usage off-peak must be shown to be cost-effective and to enhance system efficiencies.

4) DSM options which do not show an actual positive net benefit or savings should also be excluded from an incentive unless the Company can provide an adequate explanation to justify the failure of the project to achieve its projected benefits. Net benefits should be measured from the date of the introduction of the DSM option. The Company must justify to the satisfaction of the Commission why any option which failed to achieve a positive net benefit qualifies for inclusion under incentive mechanism.

5) In addition to providing net benefit data for each DSM option to qualify for the incentive, the Company must:

a) Contrast the projected costs for each option with the actual costs and explain any cost overages.

b) Contrast the projected KW and kilowatt-hour impacts and explain any failure to achieve the projection.

c) Evaluate the implementation process employed for given options which fail to achieve projected net benefits, kilowatt and kilowatt-hour impacts, and cost overages.

The final question concerning DSM expenditures relates to the selection of those programs authorized for treatment as qualifying DSM programs. As set forth in prior Commission orders, and the testimony of Staff witness Walsh, DSM programs must meet a rigorous set of tests before they are entitled to such treatment. In this regard, the Commission accepts the Supplemental Stipulation between the Staff and the Company, and finds, based on that Stipulation and on the testimony of the Company's witness Gregg, that the following DSM programs have been properly justified as being beneficial and cost-effective programs qualifying for the expense recovery and incentives: Adjustable Frequency Drive Motors; Fluorescent Lights; Electric Ballast - New; Electric Ballast - Retrofit; Great Appliance Trade-Up; Good Cents; High Efficiency Chillers; High Efficiency Indoor Lights; Commercial Roof Top - HVAC; High Efficiency Motors; Home Energy Check; Off Peak Water Heater; REC - Rate 7; Standby Generator; and Thermal Energy Storage. This

Supplemental Stipulation is attached hereto as Appendix A. The direct non-labor expenditures on these qualified DSM programs totals $4,463,603, based on the annualized actual fourth quarter 1992 expenditures on these programs.

The Commission believes that allowing the Company to earn a return on its qualified DSM expenditures satisfies the requirements of the Energy Policy Act of 1992 and the South Carolina Energy Conservation and Efficiency Act of 1992. Allowing the Company to earn a return on its DSM investment permits the Company to share in the benefits of these programs, and provides an incentive for continued investment in cost-effective DSM programs. Given the return adopted by the Commission, the Company is hereby granted $594,106 as a return on its DSM investment and as a incentive for future investment in DSM programs.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 16

Upon the identification of the revenue requirements, the Commission is responsible for the determination of the specific rates and the development of the rate structure that will yield the required revenues. It is generally accepted that proper utility regulation requires the exercise of control over the rate structure to insure that equitable treatment is afforded each class of customer.

The Commission's statutory responsibility to fix "just and reasonable rates" has been exercised by the recognition of the objective to provide a utility a fair opportunity to earn a reasonable return which meets the established revenue requirement and equitably apportions the revenue responsibility among the classes of service. In our discharge of that responsibility we have traditionally adhered to the following criteria:

> ...(a) the revenue-requirement or financial-need objective, which takes the form of a fair-return standard with respect to private utility companies; (b) the fair-cost-apportionment objective, which invokes the principle that the burden of meeting total revenue requirements must be distributed fairly among the beneficiaries of the service; and (c) the optimum-use or customer-rationing objective, under which the rates are designed to discourage the wasteful use of public utility services while promoting all use that is economically justified in view of the relationships between cost incurred and benefits received.

Bonbright, Principles of Public Utility Rates (1961), p. 292. These criteria have been consistently observed by this Commission and again are utilized in this matter.

The cost of supplying electricity to different customer classes is a function of many factors and variables. The allocation of these costs among the different classes of customers represents a complex task, since many of the total costs of producing energy are common to all customers. The procedure generally used by this Commission in analyzing utility costs in the context of the review of rate design provides for the assignment of the distribution of total costs among three major categories based on (1) costs that are a function of the total number of customers, (2) costs that are a function of the volume of the service supplied or energy costs, and (3) costs that are a function of the service capacity of plant and equipment in terms of capability of carrying hourly or daily peak loads or demand costs.

In concluding that rates should be based on cost of service principles, the Commission reflects the economic theory that regulation is intended to act as a surrogate for competition by insuring that each rate that is charged for electricity is fair and reasonable, that is, that utility rates are maintained at the level of costs, including a fair return on capital. By incorporating cost of service principles, the Commission provides for rates and charges which are designed to promote equity, engineering efficiency (cost-minimization), conservation and stability.

The foundation for an equitable and efficient cost-based rate structure is a cost of service study, which accounts for the variables and factors from which are derived the costs of supplying electricity to different classes of customers. The cost of service study not only identifies the total cost of service and thereby measures the profitability of the utility, but also identifies cost by function and class of service, and so measures the compensability of service to any one class. Furthermore, the cost of service study is used to assess the propriety of any one particular rate structure in the design of rates. In a sense, a cost of service study functions as a regulatory guide by which the ratemaker can determine the existing rate of return of each class and the manner and extent to which it should be adjusted to achieve cost-based rates.

The Company's witness How sponsored the utility's cost study and supported the resultant rates and charges. (TR. Vol. 5, How, at 106-107). The cost of service study and its underlying assumptions identified three basic types of costs: customer-related, demand-related and energy-related. Following identification (i.e., classification), the test year revenue, expense and rate base items were allocated according to function or purpose. Id. This process is essential to a fair allocation of revenue requirements for the utility system which requires the separation of the costs associated with each customer class and with the utility's jurisdictional (i.e., retail) operations. The proposed rates and charges were based on the four-hour coincident peak responsibility allocation methodology for production and transmission demand-related items, which was supported by the SCEUC and the Commission Staff.

The Company's cost of service study utilized in the design of the proposed rates and charges was founded on embedded costs. The Commission has consistently relied upon the concept of embedded costs in the implementation of ratemaking precepts. There is no evidence in the record of this proceeding to cause the Commission to abandon our well-founded reliance upon the principle of embedded cost for ratemaking purposes. The Staff, Company, Department of the Navy, and South Carolina Energy Users Committee have entered into a Stipulation in support of the single Four Hour Band Coincident Peak Methodology, which has been utilized by the Commission in all recent SCE&G rate proceedings. The Commission hereby adopts this methodology for ratemaking purposes and approves the Company's proposed cost of service study accordingly. The Commission recognizes that the cost of service study is but a tool in the development of appropriate rates for the Company.

It is axiomatic that retail rates should produce rates of return among classes that bear a reasonable relationship to overall rate of return. See, TR. Vol. 5, How, at 113. Further, there should be movement towards equal rates of return among the classes. See, TR. Vol. 6, Walsh at 215. However, although the Consumer Advocate offered no witness to address the appropriate cost of service methodology, the Consumer Advocate's brief recommends that the Commission adjust downward the portion allocated to residential customers by an amount in its discretion to "reflect the recent disproportionate increase in coincident peak demand by classes other than the residential class."

The Commission has examined this matter, and, based generally on the cross-examination of Company witness How by Consumer Advocate Staff Attorney Williamson, (TR. Vol. 5, How, at 131-159), we believe that rates should be proportioned to reflect a lesser movement toward equal returns in the Small General Service and Large General Service (Industrial) classes. As per Hearing Exhibit 23, GCH-5, the movement toward equal returns averages six (6) percentage points after SCE&G's proposed rate increase. The Commission holds that movement toward equal returns for these two classes be held to three (3) percentage points, and the increase in the residential classes be reduced in Phase I by this differential. The Commission believes that this will address the concerns of the Consumer Advocate.

In its Application, the Company requested a number of changes in its tariffs and terms and conditions of service. The proposals are discussed below.

A. Rate 7 (Residential Conservation Rate)

In its Application, the Company proposed that Rate 7 (Residential Service Conservation Rate) be converted to a retrofit rate which would apply only to homes on which construction was begun before June 1, 1993. As explained in the testimony of Company witness How, State Building Code standards concerning energy conservation have increased to a point that compliance with the requirements of Rate 7 no longer provides significant conservation benefits above generally applicable construction standards. The Staff, however, proposed a revised version of Rate 7 that includes in this Rate, for the first time, requirements as to the energy efficiency of heating and air conditioning equipment in new homes. This Revised Rate 7 has been agreed to by the Company in the Staff Stipulation at page 8. The Commission has reviewed the proposed Revised Rate 7 and finds, that in comparison to existing building code requirements, it does provide adequate conservation benefits to justify the rate reduction it provides. The Commission hereby adopts the Revised Rate 7 as a rate applicable to new homes, retrofits of existing homes, and manufactured housing.

B. Rate 9 (General Service)

The Company has proposed to change Rate 9 (General Service) to require customers with a demand exceeding 250 kva on weekdays between 1:00 p.m. and 9:00 p.m. during the billing months of June through September to either choose a different rate or to pay demand charges as specified in the tariff. In the Rate Design Stipulation, at page 2, the Company, the Staff, the South Carolina Energy Users Committee, and The Department of the Navy agreed to delay the implementation of these changes in Rate 9 until October 1993 to allow companies presently on that rate to monitor their summer peak demand and make such changes as may be required under the new rate structure.

The Commission agrees with the Company that the present Rate 9, which does not include demand charges, creates no incentive for customers with relatively high demands to conserve energy or reduce their contribution to system peak. The Commission approves the proposed revisions in Rate 9 and accepts the stipulation delaying the implementation of these revisions until October, 1993. This will allow time for the Company and its customers to explore methods of reducing peak demand in response to this revision.

C. Rate 23 and Voltage Discounts

SCE&G's Rates 23 and 24 both contain discounts for customers taking service at transmission voltages. The tariffs, as filed, provided a higher discount for transmission voltage customers taking service under Rate 23 than for transmission voltage customers taking service under Rate 24. In the stipulation concerning rate design issues, the Staff, the Company, the South Carolina Energy Users Committee and The Department of the Navy agreed that the transmission voltage discount for Rate 24 should be increased to be consistent with the similar discount approved for

Rate 23. The Commission finds this proposal to be just and reasonable and hereby adopts it.

D. Basic Facilities Charges

The Company proposes to increase the basic facilities charge applicable to each of its rates as set forth on Hearing Exhibit 23, (GCH 6). The proposed increases are in the range of between approximately 10% and 15% of the existing rates. The increase proposed for the principal residential rates, Rates 1, 2, 7, and 8 is from the $6.00 current charged per month to $6.50.

The Commission believes that the proposed basic facilities charges may be cost justified. However, the Commission further believes that denying the proposed increases in these charges would shift more of the revenue requirement to the energy portion of the tariff, thereby promoting conservation. The proposed increases to the basic facilities charges are therefore denied. The Commission does, however, adopt the establishment of $100 as a basic facilities charge for Rate Schedule 21 as proposed, since no basic facilities charge existed for this rate schedule before.

E. Miscellaneous Rate Design Issues

The Company has proposed a number of miscellaneous changes in its general terms and conditions applicable to electric service and in the terms and conditions of individual rates and rate classifications. These changes are set forth in the Application and in the testimony of Company witness Mr. How. These changes include the elimination of residential Rate 6, the division of Rate 3 into separate Municipal Power and Municipal Lighting rates, the division of Rate 12 into separate Church and School rates, a change in the minimum billing demand provision for Rates 20 and 23, the limitation of Rate 23 to industrial accounts with customer migration effective October 1, 1993 to Rate 24, changes in the Cool Thermal Storage Rider, the elimination of Rates 27 and 28 and replacement of them with an interruptible rider, the creation of a new Rate 21 to be effective in June 1994 and changes in the terms under which street lighting service will be provided in areas subject to vandalism, and the move to increase existing on-peak demand charge and the move to decrease existing off-peak demand charge in Rate 24.

The Staff has reviewed these proposed changes and has, in the Staff Stipulation, agreed that they are just and reasonable and supported by the evidence in the record. The Commission agrees and hereby authorizes these changes.

F. Changes to Individual Contract Rates

In its Application, the Company has proposed to increase its rates and charges applicable to certain contracts under which it provides services to customers, those contracts being subject to the regulatory authority of the Commission. The customers in question are: Westinghouse (DOE) Savannah River Site, the State Line accounts, Union Camp Corporation, Westvaco Corporation, Owen Electric Steel Corporation, Foster Wheeler Corporation, Richtex Corporation, and Contracted Lighting customers. The requested changes are set forth in exhibits to the Application. The Commission has reviewed these changes and finds these rates and charges should be reduced in proportion to reflect the increase approved.

G. Reconnection Charge

The Company proposes that its reconnection charge be increased from $5.00 to $25.00 during normal hours, and $5.00 to $35.00 during after hours. The Commission has approved reconnection fees of $15.00 for Duke Power Company and Carolina Power & Light Company. We believe this is sufficient for SCE&G as well, for both normal hours and after hours, and we so hold.

H. General Terms and Conditions

1. The Company requests removal of language under IIF of its general terms and conditions indicating that "underground service" booklets are approved by the Commission. The Commission approves the removal of this language.

2. The Company requests the additional of language to IIIC of its general terms and conditions, which concerns right- of-way. The language is as follows: "Customer shall maintain such right-of-way so as to grant Company continued access to its facilities by Company's vehicles and other power operated equipment." The Commission believes that the addition of this language is reasonable, and that the Company should always have access to its facilities. The Commission approves the addition of this language.

3. With regard to IIID Customer's Installation, the Company proposes adding language indicating that the customers were required to meet all applicable Code requirements. The Commission

believes that this is a reasonable addition, and hereby approves the addition of this language to the general terms and conditions as indicated.

4. In further regard to IIID in the customer installation section of the general terms and conditions, the Company proposes adding language that, should the customer elect, for any reason, to request relocation of Company's facilities, or take any action which requires such relocation, the customer may be required to reimburse the Company for all costs as a result of such relocation. The Commission believes that this is a reasonable addition to the language of the general terms and conditions and hereby approves said language.

5. With regard to IIIG of the general terms and conditions concerning Company's installation and service, the Company proposes the removal of the language indicating that the Company's Underground Installation Plan is approved by the Commission. The Commission approves this removal.

6. With regard to J.10, denial or discontinuance of service, the Company proposes to add language stating that when the Company, subsequent to application for service, receives information or determines that conditions exist which, if known at the time of the application, would have not required the Company to furnish service to the applicant, the Company may terminate service without notice. The Commission has considered the addition of this language but must deny the Company's request. The Commission believes that all discontinuances of service should require notice, except in the

instances when termination is required because of a dangerous condition. Therefore, the Commission denies the Company's proposal to modify J.10 language.

7. Further, with regard to IIIK, the reconnection section of the general terms and conditions, the Company proposes adding language that, where the Company has personnel at the customer's premises for the purpose of discontinuing service, that the Company may charge a reconnection fee at the time, even if there is no actual disconnection followed by reconnection. The Commission has examined this matter and believes that the request should be denied. Under the above-stated scenario, the Company has not disconnected service, therefore, a reconnection is not done. Application of a reconnection fee, therefore, is not reasonable. For this reason, the Commission denies the addition of this language. Also, since the Commission has herein approved a single reconnection fee of $15.00 the additional language in IIIK addressing time differentiated reconnections proposed by the Company is not necessary and is therefore denied.

CONCLUSION

The Commission herein finds that the rates as attached hereto in Appendix B produce the additional revenue requirement of $60,504,000 found fair and reasonable herein for Phase I of the increase and Appendix C for Phase II of the increase, and distributes the additional revenue responsibility consistent with the uniform distribution contained in the rates and charges proposed herein. Based upon our determinations in this Order, the additional annual revenues produced by the rates and charges approved in this proceeding for Phase I and Phase II are illustrated in the following table:

TABLE C

CLASS OF SERVICE	APPROVED INCREASE	
	PHASE I	PHASE II
Residential Service Class	$21,326,657	7,278,080
Small General Service Class	8,179,421	2,973,102
Medium General Service Class	4,082,846	1,759,780
Large General Service Class	6,370,132	5,655,377
Lighting Service Class	1,575,494	857,661
Total Rates	41,534,550	18,524,000
Reconnect	445,450	--
Total Jurisdictional (Retail Electric)	$41,980,000	$18,524,000

IT IS THEREFORE ORDERED:

1. That South Carolina Electric and Gas Company shall implement the rate schedules attached hereto as Appendix B and Appendix C and general terms and conditions for services as described herein to be effective for service rendered on or after June 7, 1993, and bills rendered on and after the first billing cycle in June 1994, respectively.

2. That SCE&G file the reports identified herein in accordance with our findings.

3. That this Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Chairman

ATTEST:

Executive Director

(SEAL)